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Date: September 8, 2014

Re: <u>FHFA Request for Input on PMI Draft Eligibility Requirements **2014-9-N**</u>

Thank you for issuing a request for public input on the draft revised eligibility requirements the Enterprises would use to approve private mortgage insurers that provide mortgage insurance on loans owned or guaranteed by the Enterprises.

Our response is primarily directed to questions **G. 16 and G. 17 Financial Requirements**: "what comments or suggestions are there related to the grid framework for performing loans…to including LTV and credit score as the primary factors in the grid framework for performing loans?"

Our primary points are: (1) mortgage insurance has, and has had, a direct impact on the availability and price of credit; (2) as a consequence, mortgage insurance policy has fair housing implications; (3) due to the policies of the GSEs' ancestor agencies, including the HOLC, risk today is impacted by how we assessed risk yesterday; therefore (4) FHFA and the GSEs have an affirmative duty under the Fair Housing Act to undo that legacy ("affirmatively promote"), and to comply with the Fair Housing Act's prohibition against discrimination in primary and secondary market activity;[1] and (5) the PMI eligibility requirements must contribute to the FHFA strategic goal of ensuring liquidity, stability, and access in housing finance.

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>
> Youngstown, O.
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> This map and the area descriptions have been carefully checked with competent local real estate brokers and mortgage lenders, and we believe they represent a fair and composite opinion of the best qualified local people. <u>**In using them we do not mean to imply that good mortgages do not exist or cannot be made in the Third and Fourth grade areas, but we do think they should be made and serviced on a different basis than in the First and Second grade areas**</u>.
>
> -HOLC Area Descriptions for Youngstown area, Ohio, 1938

The pre-WWII creation of the Federal Housing Authority (and related agencies) and its power to insure mortgages reassured lenders in a time of great uncertainty, conferring enormous benefits to an entire generation of aspiring homeowners. It was a pioneering, truly transformative government policy.

However, the HOLC "risk" assessments -- assessments that channeled mortgage lending away from many immigrant and Black neighborhoods in cities across the country -- were largely based on racial and ethnic fear and discrimination, behavior that is rightfully illegal today. While painful to read, the assessor notes remind us that our racially segregated and credit-starved neighborhoods were *created*, not a result of any "natural" or "objective" market factors. The dual credit market began with race-based "risk" assessments.

The mere sight of black children in the local school or walking to public transportation signaled "risk." From the Cuyahoga County assessor notes:

> "Although no colored people live in this area, several colored children attend Hawthorn School located on W. 130th just south of Lorain (extreme northwest corner of area)." [2]

> "Area is free from all normal detrimental influences, except for one odd situation. Colored residents from the distant fourth grade neighborhood to the southeast have acquired the habit of walking through the fields up to and along Christine Ave. in order to avail themselves of the high speed transportation on E. 131st St. This condition has created some sales resistance to properties on that street."[3]

Neighborhoods were punished for housing not only "colored" families, but Eastern European, Jewish, and Italian families; and for suffering disproportionately economically:

> "There is a gradual infiltration of foreign, principally Italian and Slavish with some negroes. The negro element, which is an overflow settlement from area D-3 (north) is concentrated on Wilton and Wainfleet Aves. in the northwest section of area. Foreclosures here are heavier than average and considerable difficulty is experienced in selling." [4]

The following eerily prescient assessor's note could be describing today's communities of color devastated by the credit and foreclosure crisis:

> "At present, <u>property values have virtually reached their maximum depreciation and sales are almost at a standstill except for speculative purposes by owners with purpose of renting to colored in mind for higher rental income</u>…The only possible improvement or change from the present rate of colored infiltration would be the renewal of industrial activity which would attract white factory workers back to this area thus creating a market for the sale of heavy institutional holdings." [5]

The exclusion of Eastern and Southern European immigrants, Jewish families, older communities, people of color, and low-income families from affordable mortgage lending provided the foundational economic infrastructure for the development of the racial wealth gap.

Half a century later, unregulated mortgage brokers and a voracious appetite for securitization allowed market players to capitalize on racialized difference, via subprime lending into previously redlined areas. The Kirwan Institute recently digitized the HOLC map of the City of Cleveland, Ohio and found that the <u>high cost loan rate in previously redlined areas to be **3-4 times** that of greenlined areas.</u> Recent investigations have shown that REO properties have been maintained better in white neighborhoods than in comparable neighborhoods of color:[6] even post-foreclosure, areas are serviced on a different basis, just as the 1938 Youngstown notes instructed.

Frankly, if we continue to assess risk primarily on factors like credit scores and loan-to-value ratio (reflecting the ability to make a significant down payment, which has a disproportionate impact on families of color) – factors that are largely correlated with generational opportunity and inherited family wealth -- <u>we are still "pricing"or "grading" on that redlined infrastructure.</u>

Given that today's Black /White wealth gap is the largest on record, and that economists agree that socioeconomic mobility has largely slid to a stop, now is exactly the wrong time to widen the already troubling gaps between people and communities. If low- and moderate-income families, immigrant neighborhoods, and communities of color are denied credit – or if that credit is higher-cost, that is, "made and serviced on a different basis" –we risk making the same mistakes that we made in 1938, policies of exclusion that left a legacy of disinvestment whose outlines can still be seen today. Without careful consideration, moving to a risk-based capital framework could become the new redlining. As the National Consumer Law Center warned:

> Racial disparities in credit scoring are a product of historical economic discrimination against minorities. Government policies that economically boosted whites while leaving minorities behind are responsible for the racial wealth gap. Credit scores act as both a numerical reflection of that gap as well as a force widening the gap." [7]

HMDA data show that there are ongoing mortgage pricing disparities by race, even when controlling for other factors. The 2013 report from the Housing Research and Advocacy Center in our home state of Ohio found that, "the data reveal continuing disparities in mortgage lending in Ohio based on both race and ethnicity. In particular, African Americans and Hispanics continue to have limited access to fair and equal credit. Both racial and ethnic groups faced higher denial rates and high-cost lending rates than Whites in the state of Ohio and in almost all of the MSAs that the Housing Center studied."[8] Consider the following scholarly analysis of this pricing issue:

> From the evidence developed so far, three distinct sets of practices emerge as potential culprits in racial mortgage price disparities. First is the role of mortgage brokers and the price discretion lenders delegate to them. Second is the role of lender assignment of borrowers to different channels and products. Third is the <u>fundamental question of the validity of the risk-based pricing models themselves</u>."[9]

The entwinement of race, history and credit scoring is both conceptually and quantitatively hard to disentangle. The FTC concluded:

> After trying a variety of approaches, the FTC was not able to develop an alternative credit-based insurance scoring model that would continue to predict risk effectively, yet decrease the differences in scores on average among racial and ethnic groups. This does not mean that a model could not be constructed that meets both of these objectives. It does strongly suggest, however, that there is no readily available scoring model that would do so.[10]

While we appreciate that "the draft … requirements are designed to reduce taxpayer risk by strengthening the role of private insurance in the mortgage market,"[11] we are concerned that private insurance companies will simply pass the cost of that risk pricing along to consumers.

Just last month, *Bloomberg* news reported that: "fewer first-time buyers are applying for loans backed by the Federal Housing Administration,[12] which require smaller down payments, after the government agency boosted mortgage-insurance premiums.[13] One could expect a similar narrowing of applications if similar price increases are passed along to the consumer from the PMIERs. The taxpayer/ borrower/ consumer will always pay the risk-adjusted premium, unless FHFA's framework can provide alternative products, programs or subsidies to ensure fair, non-discriminatory access to credit. The GSEs have the advantage of enormous scale and a mission -- and a legal mandate -- to ensure fair credit. FHFA should use its position to discourage granular risk-based pricing and promote alternative risk management strategies.

Sincerely,

9/8/2014

X Christy Rogers

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Signed by: Christy Rogers

The Kirwan Institute for the Study of Race and Ethnicity

REFERENCES

[1] "Furthering Fair Housing, the Housing Finance System, and the Government Sponsored Enterprises." Henry Korman in *Where Credit is Due: Bringing Equity to Credit and Housing after the Market Meltdown*." Rogers and powell, eds. Lanham: University Press of America, Inc. 2013.

[2] Home Owners Loan Corporation (HOLC), Residential Security "Redlining" Map, Area Descriptions, Cuyahoga County, Ohio, 1939. (B-18, p. 20; emphasis added)

[3] Home Owners Loan Corporation (HOLC), Residential Security "Redlining" Map, Area Descriptions, Cuyahoga County, Ohio, 1939. (B-32, p. 39)

[4] Home Owners Loan Corporation (HOLC), Residential Security "Redlining" Map, Area Descriptions, Cuyahoga County, Ohio, 1939. (D-2, p. 2)

[5] Home Owners Loan Corporation (HOLC), Residential Security "Redlining" Map, Area Descriptions, Cuyahoga County, Ohio, 1939. (D-17, p. 27; emphasis added)

[6] *Zip Code Inequality: Discrimination by Banks in the Maintenance of Homes in Neighborhoods of Color*. National Fair Housing Alliance. August 27, 2014. http://www.mvfairhousing.com/pdfs/2014-08-27_NFHA_REO_report.PDF

[7] *Credit Scoring and Insurance: Costing Consumers Billions and Perpetuating the Economic Racial Divide.* National Consumer Law Center and Center for Economic Justice, June 2007. https://www.nclc.org/images/pdf/pr-reports/report-insurance-scoring-2007.pdf

[8] *Racial and Ethnic Disparities in 2011 Ohio Mortgage Lending*. Krissie Wells and Ki-Duk Park. The Housing Research and Advocacy Center, Cleveland Ohio. March 2013. http://www.thehousingcenter.org/wp-content/uploads/2013/03/RED-Report-2013.pdf

[9] The author continues: "Thus, a robust review of risk-based pricing must ask at least the following questions: (1). Is each separate price adjustment independently validated based on credit loss or other lender costs independently associated with that adjustment variable, or are correlated risk factors being double-counted in the pricing model? (2.) Is the magnitude of a particular price differential associated with a particular credit variable (e.g., credit score) demonstrably commensurate with the costs associated with differences in that variable among borrowers and loans? (3.) Are post hoc explanations of pricing differences based on factors that the lender actually used in setting loan prices initially?" -- "Borrowing While Black: Applying Fair Lending Laws to Risk-Based Mortgage Pricing." Alan M. White *South Carolina Law Review* Vol. 60 (3): 2009. Pages 677-706.

[10] *Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance: A Report to Congress by the Federal Trade Commission*. July 2007. http://www.ftc.gov/sites/default/files/documents/reports/credit-based-insurance-scores-impacts-consumers-automobile-insurance-report-congress-federal-trade/p044804facta_report_credit-based_insurance_scores.pdf

[11] Private Mortgage Insurer Draft Eligibility Requirements Frequently Asked Questions (FAQ) issued 7/10/2014. http://www.fhfa.gov/Media/PublicAffairs/Pages/Draft-PMIERs-FAQs.aspx

[12] Note that FHA disproportionately serves Black and Hispanic borrowers. *The New York Times* reported this year that "Black and Hispanic borrowers are far more likely to apply for low-down-payment loans insured by the Federal Housing Administration. About 57 percent of black applicants and 60 percent of Hispanic applicants applied for F.H.A. loans, compared with 30 percent of white applicants." This means that due to increased mortgage insurance premiums, Blacks and Hispanics are now less able to apply for loans specifically intended to reach underserved borrowers.

[13] "More Money Down Adds to U.S. First-Time Buyer Blues: Economy." Michelle Jamrisko and Alexis Leondis. Bloomberg.com, August 14, 2014. Retrieved on 9/5/14 from http://www.bloomberg.com/news/2014-08-14/bigger-down-payments-add-to-u-s-first-time-homebuyer-blues.html